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COMMERCIAL TRANSACTIONS

John Krahmer*

ALTHOUGH Y2K did not produce the calamities that some had predicted, it did yield a reasonable harvest of commercial law cases. This Article summarizes the most important of these cases, but a caveat must be noted that some may have a short life-span due to the July 1, 2001 effective date of the revised Uniform Commercial Code Article 9 that was passed during the 1999 legislative session.¹ As usual, this Article follows the organization of the Texas Business and Commerce Code in its discussion of cases decided during the preceding year.²

I. GENERAL PROVISIONS

A. ACCORD AND SATISFACTION

The common law doctrine of accord and satisfaction allows the discharge of a disputed monetary obligation by the tender and acceptance of a check in full satisfaction of a claim even though the amount tendered by the debtor may be less than the amount demanded by the creditor.³ As originally enacted in Texas, Section 1.207 of the Code raised the possibility that it preempted the common law doctrine and permitted a creditor

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1. Act of June 18, 1999, 76th Leg., R.S., ch. 414, § 1.01, 1999 Tex. Gen. Laws 2639 (to be codified as TEX. BUS. & COM. CODE ANN. § 9.101-.627 (Vernon Supp. 2000)). Several of the most important changes in the revised Chapter 9 were summarized in the last Survey and have not been repeated here. See John Krahmer, *Commercial Transactions*, 53 SMU L. REV. 729, 752-60 (2000). More detailed information about the revised Chapter 9 may be found at <http://www.krahmer.net>.

2. As presently effective in Texas, the Uniform Commercial Code is contained in the first eleven chapters of the Texas Business and Commerce Code (the "Code"). See TEX. BUS. & COM. CODE ANN. §§ 1.101-11.108 (Vernon 1994 & Supp. 2000). These chapters are designated as follows:

Chapter 1: General Provisions

Chapter 2: Sales

Chapter 2A: Leases

Chapter 3: Negotiable Instruments

Chapter 4: Bank Deposits and Collections

Chapter 4A: Funds Transfers

Chapter 5: Letters of Credit

Chapter 7: Warehouse Receipts, Bills of Lading and Other Documents of Title

Chapter 8: Investment Securities

Chapter 9: Secured Transactions, Sales of Accounts and Chattel Paper

3. See, e.g., 2 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE: PRACTITIONER'S TREATISE SERIES § 16-15 (4th ed. 1995 & Supp. 2000); 6 ARTHUR CORBIN, CONTRACTS, §§ 1277-78 (2d ed. 1962).

to avoid an accord and satisfaction by striking out a debtor's condition of full payment or by adding such phrases as "Without Prejudice" or "Under Protest" to the creditor's indorsement.⁴ Section 1.207 was amended in 1995 by adding an additional subsection stating that "[s]ubsection (a) [regarding reservation of rights] does not apply to an accord and satisfaction."⁵ In *Metromarketing Services, Inc. v. HTT Headwear, Ltd.*,⁶ the court treated the section 1.207 amendment as indicative of a legislative intent to endorse the rule applied in the majority of earlier Texas cases that section 1.207 did not preempt the common law doctrine of accord and satisfaction.⁷ The court reasoned, therefore, that an attempt by a creditor to treat a check as a partial payment in the face of a debtor's notation that a check was intended as full payment would be ineffective.⁸ On the facts before the court, however, an issue still remained as to whether the full payment condition stated by the debtor on the check in question applied only to three specific invoices listed on the check or to twenty-three other invoices as well. The court held that this issue of material fact precluded summary judgment in favor of the debtor, and the case was remanded.⁹

In *Indiana Lumberman's Mutual Ins. Co. v. State of Texas*,¹⁰ the court also held that the Code did not preempt the common law doctrine of accord and satisfaction, but based its decision on earlier Texas cases without discussing the amendment to section 1.207.¹¹ Unfortunately, neither case involved application or interpretation of the 1995 revision of Chapter 3 of the Code that, for the first time, included a comprehensive section dealing with accord and satisfaction by use of a negotiable instrument.¹²

4. TEX. BUS. & COM. CODE ANN. § 1.207 (Vernon 1994). *Compare* *Pileco, Inc. v. HCI, Inc.*, 735 S.W.2d 561 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.) (holding that accord and satisfaction barred recovery when plaintiff negotiated full payment check after adding protest language to plaintiff's indorsement) *with* *Robinson v. Garcia*, 804 S.W.2d 238, 247 (Tex. App.—Corpus Christi 1991), writ denied *per curiam*, 817 S.W.2d 59 (Tex. 1991) (holding that no accord and satisfaction resulted by cashing check tendered in full satisfaction where exception to full payment condition in restrictive indorsement was noted on the check).

5. TEX. BUS. & COM. CODE ANN. § 1.207(b) (Vernon Supp. 2001).

6. 15 S.W.3d 190 (Tex. App.—Houston [14th Dist.] 2000, no pet.).

7. *See id.* at 198. The earlier cases noted by the court included *Pileco, Inc. v. HCI, Inc.*, 735 S.W.2d 561, 562 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.) (cashing check was accord and satisfaction despite protest language added by creditor); *Hixson v. Cox*, 633 S.W.2d 330, 331 (Tex. App.—Dallas 1982, writ ref'd n.r.e.) (striking of restrictive indorsement and inserting notation that check was accepting as partial payment did not avoid accord and satisfaction when check was cashed), and *Roylex, Inc. v. S & B. Eng'rs, Inc.*, 592 S.W.2d 59, 60 (Tex. Civ. App.—Texarkana 1979, no writ) (holding that creditor could not avoid accord and satisfaction by attempting to vary the conditions upon which check is tendered for payment).

8. *See* 15 S.W.3d 190.

9. *See id.*

10. 1 S.W.3d 264 (Tex. App.—Fort Worth 1999, pet. denied).

11. The cases cited by the court are included in note 7, *supra*.

12. Chapter 3 was extensively revised by the Act of May 28, 1995, 74th Leg., R.S., ch. 921, §§ 1-2, 1995 Tex. Sess. Law Serv. 4582 (Vernon). TEX. BUS. & COM. CODE ANN. § 3.311 (Vernon Supp. 2001) now deals at some length with the subject of accord and satis-

B. COURSE OF DEALING AND USAGE OF TRADE

Section 1.205 of the Code permits course of dealing and trade usage to aid in the interpretation of a contract.¹³ A course of dealing is a sequence of previous conduct between the parties under similar contracts that casts light on their understanding of the meaning of their contractual relationship.¹⁴ Usage of trade refers to how other parties, engaged in the same trade or business interpret and apply terms used in contracts like those involved in the contract in question.¹⁵ Both course of dealing and usage of trade can be excluded or superseded by the express terms of an agreement.¹⁶

Even in the absence of a clause excluding course of dealing and usage of trade, however, such evidence is not admissible if the contract is unambiguous. Thus, in *Transcontinental Gas Pipeline Corp. v. Texaco, Inc.*,¹⁷ the court of appeals held it was error for the trial court to have admitted evidence of trade usage when there was no ambiguity in the contract.

II. SALE OF GOODS

A. WHEN A SALE OCCURS

In *Lee v. The Bank*,¹⁸ the court held that the buyer of an automobile under a certified copy of a certificate of title did not acquire good title to the automobile when a prior lien on the vehicle had been released by virtue of a forgery made by a prior owner. The court noted that a registration act, such as the Certificate of Title Act, does not protect a buyer "if any link in the chain of title has been forged."¹⁹ In another certificate of title case, the court held that, in the event of conflict between the Certificate of Title Act and the Business and Commerce Code, the provisions of

faction when a "Payment in Full" condition is stated on a check or other negotiable instrument. The effect of this section has not yet been the subject of a reported case in Texas.

13. See TEX. BUS. & COM. CODE ANN. § 1.205 (Vernon Supp. 2000).

14. TEX. BUS. & COM. CODE ANN. § 1.205(a) (Vernon 1994) provides:

A course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

15. TEX. BUS. & COM. CODE ANN. § 1.205(b) (Vernon 1994) provides, in part:

A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question

16. See TEX. BUS. & COM. CODE ANN. § 1.205(d) (Vernon 1994) which provides:

The express terms of an agreement and an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable express terms control both course of dealing and usage of trade and course of dealing controls usage of trade.

17. 35 S.W.3d 658 (Tex. App.—Houston [1st Dist.], 2000, no pet. h.).

18. 23 S.W.3d 129 (Tex. App.—Austin 2000, no pet. h.).

19. *Id.* at 131. The Texas Certificate of Title Act is contained in TEX. TRANSP. CODE ANN. §§ 501.001-035 (Vernon 1999 & Supp. 2000).

the Business and Commerce Code govern.²⁰

B. STATUTE OF FRAUDS

In *Malone v. E.I. DuPont De Nemours & Co.*,²¹ a buyer and seller did not reduce their contract of sale to writing. In an action by the buyer against the seller for breach of contract, the court held that summary judgment in favor of the seller was proper because the contract was not in writing and it did not satisfy any of the exceptions to the section 2.201 statute of frauds.²² The court also held that a Deceptive Trade Practices Act (DTPA) claim asserted by the buyer was barred because the alleged failure of the seller to sell as much paint as the buyer wanted to buy was not based on a defect in the goods but was a mere complaint about the quantity the buyer wanted to purchase.²³ As such, the buyer was not a "consumer" for DTPA purposes since the goods themselves did not form the basis of the complaint.²⁴

C. WARRANTIES

Buyers have four basic theories of warranty recovery available to them under the Code in contracts for the sale of goods: (1) breach of a warranty of title;²⁵ (2) breach of an express warranty;²⁶ (3) breach of an implied warranty of merchantability;²⁷ and (4) breach of an implied warranty of fitness for a particular purpose.²⁸ Claims for breach of warranty may also overlap claims based on strict liability, negligence, or deceptive trade practices act violations.²⁹ Regardless of any overlap, however, a fundamental element of any of these claims is that some form of legally cognizable damage results.

20. See *Hudson Buick, Pontiac, GMC Truck Co. v. Gooch*, 7 S.W.3d 191 (Tex. App.—Tyler 1999, pet. denied); see also TEX. TRANSP. CODE ANN. § 501.005 (Vernon 1999).

21. 8 S.W.2d 710 (Tex. App.—Fort Worth 1999, pet. denied).

22. See *id.* at 714-15. TEX. BUS. & COM. CODE ANN. § 2.201 (Vernon 1994) requires that a contract for the sale of goods in an amount greater than \$500.00 be in writing or that the party against whom enforcement is sought: (1) be a merchant who has not objected to a writing in confirmation of the contract sent by the other party; or (2) has ordered goods that are to be specially manufactured and are not suitable for sale to others; or (3) has admitted in pleadings, testimony or otherwise in court that a contract exists; or (4) has made a partial payment or has partially performed the contract.

23. 8 S.W.3d at 715. The Deceptive Trade Practices Act appears as TEX. BUS. & COM. CODE ANN. §§ 17.41-.63 (Vernon 1987 & Supp. 2000).

24. 8 S.W.3d at 715. Under TEX. BUS. & COM. CODE ANN. § 17.45(4) (Vernon Supp. 2000), a "consumer" must seek or acquire goods by purchase or lease and the goods must form the basis of the complaint. The requirement that the goods form the basis of the complaint has been long-standing under the DTPA. See *Cameron v. Terrell & Garrett, Inc.*, 618 S.W.2d 535, 539 (Tex. 1987) (op. on reh'g).

25. See TEX. BUS. & COM. CODE ANN. § 2.312 (Vernon 1994).

26. See *id.* at § 2.314.

27. See *id.* at § 2.315.

28. See *id.* at § 2.315.

29. Some examples of such overlapping claims are discussed in John Krahmer, *Commercial Transactions*, 53 SMU L. REV. 729, 734-737 (2000) and in the prior Survey articles noted there.

In *Coghlan v. Aquasport Marine Corp.*,³⁰ the plaintiffs purchased a boat from the defendant seller which was represented to be made entirely of fiberglass. In fact, the boat deck was constructed of one and one-half inches of plywood encased in fiberglass. The plaintiffs sued under the federal Magnuson-Moss Warranty Act for breach of a written warranty and for breach of an implied warranty of fitness for a particular purpose as well as for various forms of fraud and misrepresentation.³¹ The court held that regardless of the theory on which the suit was based, the plaintiffs were required to plead some "concrete and palpable" injury beyond a mere allegation that it was possible that the fiberglass coated wood might rot or that the resale value of the boat might be diminished.³² Noting that precedent required damages to be "actual and palpable in order to be legally cognizable," the court dismissed the complaint without prejudice because the damages alleged in the complaint were purely hypothetical.³³ On the claim for breach of the implied warranty of fitness for a particular purpose, the court further noted that the plaintiffs had not alleged a particular purpose for which the boat was to be used but had only alleged that it would be used for its ordinary purpose as a fishing boat.³⁴ Because of the failure to allege a particular purpose, which was the stated basis for invoking the Magnuson-Moss Warranty Act, the warranty claims were dismissed on this ground as well.³⁵

Although the requirements of the Magnuson-Moss Warranty Act were not met in *Coghlan*, the plaintiffs in *In re Van Blarcum*³⁶ used Magnuson-Moss successfully to challenge a trial court order for arbitration of a breach of warranty claim based on alleged defects in a mobile home. In *Van Blarcum*, the plaintiff consumers purchased a mobile home under a retail installment contract that provided that all disputes arising out of the purchase of the mobile home were to be resolved by arbitration under the Federal Arbitration Act.³⁷ The contract also stated that its provisions would inure to the benefit of the seller, the manufacturer, and any lender that financed the purchase of the mobile home.³⁸ After numerous complaints about defects in the construction of the mobile home went unheeded, the Van Blarcums sued all three of these parties both for breach of express written warranties and for breach of implied warranties. The defendants moved to compel arbitration and their motion was granted.³⁹ The Van Blarcums then sought mandamus relief to reverse the order of the trial court and to permit them to proceed with their state court

30. 73 F.Supp.2d 769 (S.D. Tex. 1999).

31. The Magnuson-Moss Warranty Act is a federal law establishing standards for written warranties in the sale of consumer goods. See 15 U.S.C.A. §§ 2301 -12 (2000).

32. *Coghlan v. Aquasport*, 73 F. Supp. 2d at 772.

33. *Id.*

34. See *id.* at 774-75.

35. See *id.* at 775.

36. 19 S.W.3d 484 (Tex. App.—Corpus Christi 2000, no pet.).

37. See *id.* at 488.

38. See *id.*

39. See *id.*

lawsuit.⁴⁰

In what the court characterized as an issue of first impression in Texas, the Van Blarcums argued that a warrantor of consumer goods under Magnuson-Moss is prohibited from using a contract clause in a contract signed at the time of purchase to require binding arbitration as a dispute resolution mechanism for warranty claims.⁴¹ After a careful review of the Magnuson-Moss Warranty Act, Federal Trade Commission rules, guides, and interpretations of the act, and the limited number of prior cases involving the issue, the court concluded that Magnuson-Moss did, indeed, override the Federal Arbitration Act in regard to both express warranty claims and implied warranty claims and rendered sales contract clauses requiring arbitration of such claims invalid and unenforceable.⁴² A dissenting opinion agreed that Magnuson-Moss prohibited the use of arbitration for written warranty claims but did not prohibit arbitration of implied warranty claims.⁴³

Whether *Van Blarcum* will be followed by other Texas courts remains to be seen. However, with the increased use of arbitration as a way to resolve warranty disputes in recent years, this is a case of some importance because of its perspective on the relationship between arbitration and litigation on the subject of consumer product warranties under Magnuson-Moss.⁴⁴

Arbitration also figured in the case of *Edwards v. Schuh*,⁴⁵ but in the context of commercial litigation, where the court denied arbitration between the builder of three warehouses and the subsequent purchasers of the warehouses on the ground that the only arbitration clause appeared in the original construction contract and the subsequent purchasers were

40. See *id.* at 489.

41. See *id.* at 487.

42. See *id.* at 496. The Federal Trade Commission rules, guides, and interpretations are collected in "Final Action Concerning Review of Interpretations of Magnuson-Moss Warranty Act; Rule Governing Disclosure of Written Terms and Conditions; Rule Governing Disclosure of Written Consumer Product Warranty Terms and Conditions; Rule Governing Pre-Sale Availability of Written Warranty Terms; Rule Governing Informal Dispute Settlement Procedures; and Guide For the Advertising of Warranties and Guarantees," 64 Fed. Reg. 19700 (1999). The principal case on which the court relied was *Southern Energy Homes, Inc. v. Lee*, 732 So.2d 994 (Ala. 1999).

43. See *Van Blarcum*, 19 S.W.3d at 498.

44. The reader may find it an interesting legal process exercise to compare the decision in *In re Conseco Finance Servicing Corp.*, 19 S.W.3d 562 (Tex. App.—Waco 2000, no pet.) with the decision in *Van Blarcum*. *Conseco* was decided almost exactly one month before *Van Blarcum*, but the decision addressed, *inter alia*, the question of whether an arbitration clause in a contract for the sale of a manufactured home was unconscionable and, therefore, unenforceable where the consumer plaintiffs sought to avoid arbitration in a case where they had defaulted on their loan payments. Relying on general public policy favoring arbitration, and feeling itself bound by the decision of the Texas Supreme Court in *In re Oakwood Mobile Homes*, 987 S.W.2d 571, 573 (Tex. 1999), the court held that arbitration could be compelled. The next few years may well produce an interesting collection of cases on the relationship between warranties, arbitration, and public policy that is just as complex as that currently existing in the intersection between warranties, strict liability, negligence, and the DTPA.

45. 5 S.W.3d 829 (Tex. App.—Austin 1999, no pet.).

not parties to that contract. The only document received by the subsequent purchasers from the builder contained an express warranty regarding the buildings and did not contain an arbitration clause. The court, therefore, held that arbitration could not be compelled when the purchasers were not signatories to the arbitration agreement.⁴⁶

In *Helena Chemical Co. v. Wilkins*,⁴⁷ three farmers asserted breach of warranty and DTPA claims for the failure of cotton seed to produce the expected yields. An issue of first impression was whether the suit was barred because the farmers had delayed in submitting their claims to arbitration as required by the Texas Agricultural Code.⁴⁸ On this issue, the court held that mere delay in submitting their claims, as contrasted to a failure to submit the claims at all, did not bar the farmers' suit.⁴⁹ As to the merits of the warranty and DTPA claims, the court held that disclaimers of implied warranties that were stated on the seed bag, on the purchase ticket, and on the invoices were effective for the seller to avoid liability on the breach of warranty theory.⁵⁰ The court also held, however, that the disclaimers were not effective to avoid liability on the grounds of misrepresentation and unconscionability asserted as independent causes of action under the DTPA.⁵¹ Similarly, the court held that an attempted limitation of liability was effective only as to the warranty claims and not as to the DTPA claims.⁵²

In *Buecher v. Centex Homes*,⁵³ a group of homeowners brought a class action to enjoin a builder from enforcing a waiver of the warranties of habitability and good workmanship contained in the contracts by which they had purchased their homes.⁵⁴ The question before the court was whether the holding in *Melody Home Mfg. Co. v. Barnes*⁵⁵ that a warranty of good workmanship could not be waived or disclaimed extended to the warranty of habitability that had been adopted in *Humber v. Morton*.⁵⁶ The resolution of this issue hinged on the interpretation of a somewhat cryptic sentence in the *Melody Home* opinion where the court stated, "To the extent it conflicts with this opinion, we overrule *G-W-L*,

46. See *id.* at 833.

47. 18 S.W.3d 744 (Tex. App.—San Antonio 2000, pet. granted).

48. TEX. AGRIC. CODE ANN. § 64.002 (Vernon 1995) requires a purchaser to submit seed claims to arbitration as a prerequisite to maintaining legal action. Although the arbitration is non-binding, submission to arbitration is required. See *Helena Chemical*, 18 S.W.3d at 750-51.

49. See *Helena Chemical*, 18 S.W.3d at 751-52.

50. See *id.* at 757.

51. See *id.* at 757-58.

52. See *id.*

53. 18 S.W.3d 807 (Tex. App.—San Antonio 2000, pet. granted).

54. The warranty of habitability was adopted as a common law warranty applicable to the sale of homes in *Humber v. Morton*, 426 S.W.2d 554, 562 (Tex. 1968). The warranty of good workmanship was adopted several years later in *Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987).

55. 741 S.W.2d 349 (Tex. 1987).

56. 426 S.W.2d 554 (Tex. 1968).

Inc. v. Robichaux.⁵⁷ In *G-W-L* the court held that disclaimers of the warranty of habitability would be effective so long as they were "clear and free from doubt."⁵⁸ The interpretive difficulty, of course, was to determine the *extent* to which *G-W-L* had been overruled, an issue that was noted several years ago in an earlier Survey and that has only now reached a court of appeals.⁵⁹

The court reasoned that the rationale for prohibiting the disclaimer of the implied warranty of good workmanship adopted in *Melody* applied with equal force to the warranty of habitability in the construction of new homes.⁶⁰ As a matter of public policy, therefore, the court held that the attempted disclaimer was unenforceable.⁶¹ A concurring opinion agreed that the majority had correctly pieced together the *Humber*, *Melody Home*, and *G-W-L* puzzle, but expressed the view that *Melody Home* should be reconsidered by the Supreme Court.⁶² A dissenting opinion argued that *G-W-L* survived *Melody Home* because the anti-waiver holding in *Melody Home* was addressed only to a warranty of good workmanship in the repair of tangible property and not to the sale of new homes.⁶³

A petition for review has been granted in *Buecher*. If an opinion is eventually forthcoming, it may be of considerable importance in clarifying the matter of how and when the common law warranties of habitability and good workmanship can be disclaimed or if they can be disclaimed at all.

The issue of federal preemption of state law warranty claims was raised in *Cole v. Central Valley Chemicals, Inc.*,⁶⁴ where several farmers sued a seller of herbicides for DTPA violations and for negligent misrepresentation. The court held that these claims were not preempted by the Federal Insecticide, Fungicide and Rodenticide Act.⁶⁵ This act preempts common law tort claims relating directly or indirectly to labeling. In the case at bar, however, the claims were based on oral representations made by the seller's sales representative, and the court held that these claims were not preempted.⁶⁶ The court also held that sufficient evidence had been adduced by the farmers to show that the misrepresentations were both a producing cause and a proximate cause of the lower crop yields they suffered after application of the herbicide.⁶⁷ The defendants also argued that the claim for alleged misrepresentations was excluded from the DTPA as

57. *Melody Home*, 741 S.W.2d at 355 (referring to *G-W-L, Inc. v. Robichaux*, 643 S.W.2d 392 (Tex. 1982)).

58. *G-W-L*, 643 S.W.2d at 393.

59. See John Krahmer, *Commercial Transactions*, 42 Sw. L.J. 217, 224 at n. 48 (1988).

60. See *Buecher*, 18 S.W.3d at 811.

61. See *id.*

62. See *id.* at 812.

63. See *id.* at 813.

64. 9 S.W.3d 207 (Tex. App.—San Antonio 1999, pet. denied).

65. 7 U.S.C.A. § 136 *et seq.* (1980).

66. See 9 S.W.3d at 210.

67. See *id.* at 211-12.

a professional service.⁶⁸ There was no case law construing this portion of the DTPA, and the court concluded that the farmers' claims were based, not on the purchase of a professional service, but on the purchase of goods and were, therefore, actionable under the DTPA.⁶⁹

Breach of an express warranty of title can be the basis for both a breach of warranty claim and a Deceptive Trade Practices Act claim for misrepresentation. In *Munawar v. Cadle Co.*,⁷⁰ the court held that both claims would lie for breach of an express warranty of title covering real and personal property and that neither the doctrine of merger by deed nor the parol evidence rule would exclude proof of the seller's representations regarding the transfer of good title to the property.

In *Perry v. Breland*,⁷¹ the court held that contractual privity is not required in an action for breach of a warranty of good title against a remote vendor. The court also suggested in dicta that a warranty of good title is not breached if the seller transfers a voidable title, but it qualified this statement by pointing out that it had only a limited record before it and that this issue should be addressed on remand.⁷²

D. BREACH AND DAMAGES

In *Cook Composites, Inc. v. Westlake Styrene Corp.*,⁷³ a buyer failed to provide written evidence of a competitor's price sufficient to invoke a "meeting competition" clause in a contract. Despite failing to produce

68. TEX. BUS. & COM. CODE ANN. § 17.49(c) (Vernon Supp. 2000) provides in part: (c) Nothing in this subchapter shall apply to a claim for damages based on the rendering of a professional service, the essence of which is the providing of advice, judgment, opinion, or similar professional skill. This exemption does not apply to: (1) an express misrepresentation of a material fact that cannot be characterized as advice, judgment, or opinion

69. See *Cole v. Central Valley Chems.*, 9 S.W.2d at 210. The court explained its reasoning as follows:

The Coles assert that they did not go to CVC to pay for or receive professional services, but rather to buy a herbicide. The Coles argue that construing [the salesperson's] recommendation as a professional service would abolish the DTPA whenever a consumer purchased a product based on the advice of the salesman. In this case, we find that the Coles's claim is not based on the rendering of a professional service but, rather on the purchase of Surpass 100. Thus, section 17.49 of the DTPA does not preclude the Coles's claim and CVC failed to establish as a matter of law that it is entitled to summary judgment on its affirmative defense of exclusion.

70. 2 S.W.3d 12 (Tex. App.—Corpus Christi 1999, no pet.).

71. 16 S.W.3d 182 (Tex. App.—Eastland 2000, pet. denied).

72. See *id.* at 191. While the suggestion is only dicta, it is a somewhat unfortunate statement since prior Texas cases have held that a breach of the warranty of good title occurs if there is a disturbance of the buyer's right to quiet possession, even if the buyer ultimately prevails in litigation with the person who claims title. See, e.g., *Saenz Motors v. Big H. Auto Auction, Inc.*, 653 S.W.2d 521 (Tex. App.—Corpus Christi 1983), *aff'd*, 665 S.W.2d 756 (Tex. 1984) (disturbance of quiet possession sufficient to breach warranty of title); *Trial v. McCoy*, 553 S.W.2d 199 (Tex. Civ. App.—El Paso 1977), *appeal after remand*, 581 S.W.2d 792 (Tex. Civ. App.—El Paso 1979) (warranty of title breached when gun was seized by police on information that it was stolen property; no requirement that buyer prove that gun was actually stolen).

73. 15 S.W.2d 124 (Tex. App.—Houston [14th Dist.] 2000, pet. dismissed).

such evidence, the buyer contended that it had reasonable grounds for insecurity and was justified in treating the seller's refusal to reduce its price as an anticipatory repudiation. The court held that the buyer had no reasonable grounds for insecurity and no grounds to request adequate assurance of performance under section 2.609 of the Code.⁷⁴ Instead, the court ruled that the buyer itself was in breach for refusing to accept further deliveries of goods under the contract.⁷⁵ As to the seller's damages, the court found that although the seller did not qualify for the recovery of resale damages because of a failure to plead that it had met the requirements of notice and commercial reasonableness under section 2.706, the seller was entitled to recover damages under the general contract/market price formula stated in section 2.708.⁷⁶

In *Elias v. Mr. Yamaha, Inc.*,⁷⁷ a buyer made a down-payment for the purchase of a jet ski, partly in cash and partly by trading in an old jet ski. The dealer sold the jet ski taken in trade and failed to deliver the new jet ski. In an action against the dealer for breach of contract, DTPA violations, fraud, and conversion, the court held that the buyer was entitled to recover for the failure to deliver the new jet ski and for loss of use for ten days during which the new jet ski could be used.⁷⁸

E. STATUTE OF LIMITATIONS

In *Pecan Valley Nut Co., Inc. v. E.I. du Pont de Nemours & Co.*,⁷⁹ the court held that breach of warranty claims were barred by the four year limitations period in section 2.725 of the Code, but that the discovery rule in section 17.565 of the Deceptive Trade Practices Act tolled the two year limitations period applicable to the DTPA claims.⁸⁰ The difference in treatment of the two limitations periods is due to the lack of a discovery rule in section 2.725, which starts the limitations period upon tender of delivery, whether or not a defect has been discovered at that time. Under section 17.565 in the DTPA, a cause of action arises when the plaintiff knows or should have known that a wrongful injury has occurred. As illustrated by this case, this disparity can sometimes cause a seemingly anomalous result in which the longer limitations period expires before the shorter limitations period has run.

74. See *id.* at 140 (discussing TEX. BUS. & COM. CODE ANN. § 2.609 (Vernon 1994)).

75. See *id.*

76. See *id.* at 137-39 (discussing TEX. BUS. & COM. CODE ANN. §§ 2.706 & .708 (Vernon 1994)).

77. 33 S.W.3d 54 (Tex. App.—El Paso 2000, no pet.).

78. See *id.* at 62.

79. 15 S.W.3d 244 (Tex. App.—Eastland 2000, pet. filed).

80. See *id.* at 247-49 (discussing TEX. BUS. & COM. CODE ANN. § 2.725 (Vernon 1994) & TEX. BUS. & COM. CODE ANN. § 17.565 (Vernon 1987)).

IV. NEGOTIABLE INSTRUMENTS

A. TRANSFER OF INSTRUMENTS AND LIMITATIONS ON ACTIONS

The transfer of a negotiable instrument may be the most common area in which actual behavior deviates most markedly from legal theory. The theory is very simple: if an instrument specifies a payee, that payee, and that payee alone, is entitled to indorse the instrument for purposes of transfer.⁸¹ Some additional rules are applicable to determine the person who must indorse an instrument following its initial transfer.⁸² In real life, however, indorsements may vary slightly from the name specified on an instrument (e.g., a check payable to "Acme Corp." might be deposited under the stamped indorsement of "Acme Corporation"), or vary more seriously (e.g., a note payable to "John Paul Jones" might be indorsed simply as "John Jones"), or the indorsement might be missing in its entirety. Although the Code tries to make allowances for the human predilection to use abbreviations, shorthand phrases, misspellings, and even omissions, the transfer of an instrument that varies in any way from the requirements of legal theory can lead to problems when money is at stake. This point is nicely illustrated in the cases of *Boyd v. Diversified Fin. Systems*⁸³ and *Bosque Asset Corp. v. Greenberg*.⁸⁴

In *Boyd*, the court held that a note acquired by the FDIC in its receivership capacity could be indorsed by the FDIC in its corporate capacity without affecting the validity of the indorsement. The court further held that a "Loan Sale Agreement" between FDIC-Corporate and a private loan buyer was effective to transfer an associated guaranty of the note to the buyer and to permit the buyer, as a holder in due course, to recover against a guarantor. In addition, the court held that a waiver contained in the guaranty agreement effectively waived the defense of impairment of collateral whether or not the note buyer qualified as a holder in due course.

In *Bosque*, the court considered two matters regarding the transfer of instruments. First, was there sufficient evidence to show that the assignee was the owner or holder of the note in question when there were two apparent breaks in the chain of transfer?

On this issue, the court held that a Declaration of Insolvency by the Comptroller of the Currency was a self-authenticating record sufficient to show that the bank named as payee on the note and the bank that was declared insolvent by the FDIC were the same entities despite a slight difference in name.⁸⁵ The court further held that no indorsement by FDIC-Receiver was required to transfer the note to FDIC-Corporate.⁸⁶

81. See TEX. BUS. & COM. CODE ANN. § 3.204 (Vernon Supp. 2000).

82. See *id.* at § 3.205.

83. 1 S.W.3d 888 (Tex. App.—Dallas 1999, no pet.).

84. 19 S.W.3d 514 (Tex. App.—Eastland 2000, pet. denied).

85. See *Bosque Asset*, 19 S.W.3d at 518. The named payee was "First National Bank;" the entity declared insolvent was "First National Bank of Garland."

86. See *id.* at 519.

Thus, there were no actual breaks in the chain of transfer prior to acquisition of the note by the assignee.

Second, the plaintiff-assignee had not acquired the note directly from the FDIC. Instead, plaintiff acquired the note from a prior assignee who had purchased the note from the FDIC and filed an action on it against the defendant maker within the six-year limitations period allowed to such assignees. After purchasing the note, the subsequent assignee intervened in this action more than six years after the due date. The court held that the benefit of the six-year limitation period ran to subsequent assignees as well as to the first assignee from the FDIC, and that a late intervention was not barred where the intervenor was merely suing on the same note that was in issue when the original petition was filed.⁸⁷

To some extent, the issue of whether the state or federal limitations period applies to negotiable notes has disappeared following the 1995 revision of Chapter 3 of the Code.⁸⁸ During any transition period, however, there is always the problem of relating old time periods to new time periods. Addressing this issue, *Whittle v. MCorp Properties*⁸⁹ held that if a shorter limitations period has not fully run on the date that a longer limitations period becomes effective, the longer limitations period will apply because there is no vested right in a limitations period until it has actually expired.⁹⁰ In *Whittle* the defendant maker of a note sought to use the four-year limitations period to bar an action against him for unpaid installments due more than four years but less than six years after the 1995 revisions became effective. As noted by the court, the limitation bar began running when the maker failed to make his payments, but the limitations defense had not vested when the revised Chapter 3 became effective.⁹¹ Because the defense of limitations had not matured when suit was brought, the suit was timely when it was filed within the new six-year limitations period.⁹²

As a counter-point to the decision in *Whittle*, however, it must be noted that the six-year limitations period is only applicable to suits on a promissory note and not to suits on underlying contracts which are still governed by a four-year limitations period. Thus, in *Rampart Capital Corp. v. Egmont Corp.*,⁹³ the court held that claims based on breach of contract and breach of a fiduciary duty were governed by a four-year limitations period rather than the six-year limitations period for claims based on a

87. See *id.* at 520-22.

88. Prior to the revision, a two-year limitation period under state law applied to negotiable notes. See TEX. CIV. PRAC. & REM. CODE §§ 16.003 -.004 (Vernon Supp. 2000). However, this time period conflicted with the six-year limitation period permitted under federal law by 12 U.S.C.A. § 1821(d)(14) (West 1989 & Pamph. Supp. 1999). As revised, TEX. BUS. & COM. CODE ANN. § 3.118 (Vernon Supp. 2000) now provides the same six-year limitations period for negotiable notes as provided by federal law.

89. 17 S.W.3d 718 (Tex. App.—Amarillo 2000, no pet.).

90. See *id.* at 721.

91. See *id.*

92. See *id.*

93. 18 S.W.3d 318 (Tex. App.—Beaumont 2000, no pet.)

promissory note.⁹⁴

B. MATERIAL ALTERATION

The surety in an agreement between a land development company and a lending institution offered a \$200,000 Certificate of Deposit as collateral on a \$865,000 loan. In the course of filling out the papers a clerical error was discovered, changed, and initialed by the land developers and the lending institution. Notification of the change was not given to the surety. The error was made in the maturity date of the Certificate of Deposit, changing it from two years, as printed, to the one year that was intended. After the land developers defaulted, the bank foreclosed on the \$200,000 Certificate of Deposit and credited that amount toward the unpaid balance of the loan.

In *Frost Nat'l Bank v. Burge*,⁹⁵ the court agreed with the bank that no material alteration had taken place. The surety argued that changing the maturity from two years to one year would discharge his obligation. The court found, through a review of other documents executed at the same time, for the same purpose, and in the course of the same transaction, that the intent of the parties was for a one year maturity, not two years. This finding that no material alteration occurred also defeated the surety's conversion claim.

C. LIABILITY OF CO-MAKERS, ACCOMMODATION PARTIES, AND GUARANTORS

In *Caprock Inv. Corp. v. FDIC*,⁹⁶ a group of borrowers, including a corporation, executed a promissory note in favor of a bank to purchase mineral leases. When the borrowers defaulted, the bank commenced foreclosure proceedings. Subsequently, one of the borrowers filed for bankruptcy protection. The action against this borrower was severed from the state proceedings.

Two years later the bank failed and all of its assets were transferred to the FDIC as receiver. Three years after the bank failure, the corporate borrower filed a counterclaim in the state action and one of the individual borrowers intervened. In the meantime, the FDIC sold the note to an investment company. The investment company sought to intervene and substitute itself for the bank. It also filed an amended petition suing the corporation and the remaining borrowers individually. The corporation and the borrowers objected to the intervention. The trial court denied the investment company's motion to intervene and granted summary judgment for the borrowers.

94. Breach of contract and breach of fiduciary duty claims are governed by TEX. CIV. PRAC. & REM. CODE § 16.004 (Vernon Supp. 2000) instead of by TEX. BUS. & COM. CODE ANN. § 3.118 (Vernon Supp. 2000).

95. 29 S.W.3d 580 (Tex. App.—Houston [14th Dist.] 2000).

96. 17 S.W.3d 707 (Tex. App.—Eastland 2000, pet. denied).

On appeal, the court held that the investment company had a right to intervene because it could have brought the same action in its own name.⁹⁷ The borrowers argued that because the investment company never produced a schedule of assets described in the contract of sale between the FDIC and the investment company, it could not prove that it was the owner of the note and, therefore, it had no right to intervene. The court disagreed and held that proof of "transfer of a note may be proved by testimony as well as by documentation."⁹⁸ In the case at bar, the court ruled that testimony introduced on behalf of the investment company was sufficient to prove a transfer of the note and that the failure to produce the asset schedule was not fatal to its ability to prove that it owned the note.⁹⁹

The makers also argued that the discharge in bankruptcy of the non-party co-maker satisfied their obligations on the note as a matter of law. The court again disagreed, stating that although the bankruptcy court's confirmation of a plan binds a debtor and all creditors as to that debtor, a discharge in bankruptcy does not alter the rights of a creditor to collect from third parties.¹⁰⁰ The court stated that it was "clear from the language and history of section 524(e) of the Bankruptcy Code that the discharge of a debtor's obligation by operation of the Bankruptcy Code does not discharge or affect in any way a co-maker's liability on his obligation."¹⁰¹

In *The Cadle Co. v. Regency Homes, Inc.*,¹⁰² the holder of a variable rate note issued to a failed bank, and subsequently sold by the FDIC to the holder, sued a guarantor who had signed an unlimited guaranty covering all debts of the maker owed to the bank. In a careful analysis of prior caselaw regarding variable rate notes indexed to the prime rate of failed banks, the court held that the holder of a variable rate note is entitled to introduce evidence of a reasonable rate of interest in lieu of the ability to ascertain the prime rate of a defunct bank.¹⁰³

The guarantor attempted to avoid liability on the guaranty by arguing that the note had already been paid in full, but the court found that there was a failure of proof on this issue.¹⁰⁴ The guarantor also argued that the disposition of collateral securing the note had been commercially unreasonable. However, because the note holder was suing only on the note itself and not for recovery of a deficiency judgment, the court held that the rule barring recovery of a deficiency in the case of a commercially unreasonable disposition of collateral did not apply.¹⁰⁵

97. *See id.* at 710.

98. *Id.* at 711.

99. *See id.*

100. *See id.* at 712.

101. *Id.* at 712 (citing 11 U.S.C.A. § 524(e) (West 1993)).

102. 21 S.W.3d 670 (Tex. App.—Austin 2000, pet. denied).

103. *See id.* at 678-80.

104. *See id.* at 678.

105. *See id.* at 680-81. The rule barring recovery of a deficiency judgment following the commercially unreasonable disposition of collateral (generally termed the "absolute bar"

In *Taylor-Made Hose, Inc. v. Wilkerson*,¹⁰⁶ on a rehearing *en banc*, by a four to three majority, the court withdrew a prior panel decision and issued a new opinion. The new opinion held that the Vice President of a corporation who had signed a credit application on behalf of the corporation was personally liable as a guarantor of the corporate debt. A clause in the credit application stated that the signer “personally agree[d] to pay all invoices and cost of collection on any amount remaining unpaid after 90 days.”¹⁰⁷ The court ruled that, as a matter of law, this clause unambiguously made the signer a guarantor who was personally liable for the corporation’s debt.¹⁰⁸ A strong dissenting opinion by three of the seven judges argued that the clause was, indeed, ambiguous and that the majority had changed the Texas law favoring obligors on guaranty agreements to a rule favoring obligees.¹⁰⁹

VI. SECURED TRANSACTIONS

A. SCOPE OF FUTURE ADVANCE CLAUSES

In *In re Conte*,¹¹⁰ a debtor borrowed money to purchase a car. The loan documents contained a cross-collateralization and future advance clause

rule) was adopted in Texas in *Tanenbaum v. Economics Laboratory, Inc.*, 628 S.W.2d 769 (Tex. 1982) and has since been applied in numerous Texas cases. See, e.g., *Milliorn v. Finance Plus, Inc.*, 973 S.W.2d 690 (Tex. App.—Eastland 1998, no pet.) (failure to give notice of public sale of collateral note barred recovery of deficiency, but creditor entitled to recover on a separate note not involved in commercially unreasonable foreclosure sale); *Havins v. First Nat’l Bank*, 919 S.W.2d 177 (Tex. App.—Amarillo 1996, no writ) (sale of collateral in a recognized market does not require prior notice, but record did not show that livestock auction was a recognized market; absent proof of notice and commercially reasonable disposition or that sale was in a recognized market, creditor not entitled to recover deficiency); *ITT Comm. Fin. Corp. v. Riehn*, 796 S.W.2d 248 (Tex. App.—Dallas 1990, no writ) (creditor who elects to sell collateral must both give notice and sell in commercially reasonable manner to recover deficiency; failure to meet either requirement makes sale an act of conversion).

One of the significant changes made by the revised Chapter 9 that became effective in Texas on July 1, 2001 is the abolition of the absolute bar rule in commercial cases, thus effectively repealing *Tanenbaum* and its progeny. See TEX. BUS. & COM. CODE ANN. REV. § 9.611(c) (Vernon Supp. 2000). Revised Chapter 9 adopts, instead, the “rebuttable presumption rule” under which the failure to conduct a commercially reasonable disposition of collateral creates a presumption that the value of collateral equalled the amount of the debt and puts the burden of proof on the secured party to show why the disposition did not yield a sufficient return to pay the entire debt. Revised Chapter 9 takes no position on the rule to be applied in consumer cases. See TEX. BUS. & COM. CODE ANN. REV. § 9.611(c) (Vernon Supp. 2000).

106. 21 S.W.3d 484 (Tex. App.—San Antonio 2000, pet. filed).

107. See *id.* at 488.

108. See *id.* at 488-89.

109. *Id.* at 489. The first paragraph of the dissenting opinion states:

In a strikingly bold stroke, the majority greatly expands the law of guaranty to favor any poorly-worded attempt by a business entity to hold the employee or officer of a customer business personally liable for credit extended to the company. After years of holding to the contrary, the law in Texas now has suddenly swung from favoring the obligor, to favoring the obligee.

At this writing, a petition for review has been filed in *Taylor-Made Hose* and, given the deep division in the Court of Appeals, a decision by the Texas Supreme Court may have important implications for the Texas law of guaranties.

110. 206 F.3d 536 (5th Cir. 2000).

providing that the car would serve not only as collateral for the car loan, but also for any future loans that the creditor might make to the debtor. The debtor subsequently applied for and received a credit card from the creditor. The debtor eventually paid off the car loan and requested that the creditor release the certificate of title to the vehicle. The creditor refused because the debtor had an outstanding credit card balance in excess of \$7,000.00. In the debtor's ensuing bankruptcy proceeding, the court held that the cross-collateralization and future advance clause was effective to continue a security interest in the car since the credit card advances were reasonably within the contemplation of the parties when the loan agreement was made, as required by Texas law.¹¹¹

B. RELATIONSHIP BETWEEN ACCOUNT DEBTORS AND ASSIGNEES

A common financing pattern under Chapter 9 involves a three-party transaction where a secured party provides the initial financing to a debtor. The secured party then assigns its rights to a third party either by sale of the security interest or by using the underlying security interest as collateral for a loan from a third party. When such a transaction occurs, the original debtor becomes an "account debtor" vis-a-vis the assignee with respect to further payments on the account, chattel paper, or general intangible that secured the original security interest.¹¹² In such transactions, if the account debtor has a recoupment or setoff claim against the original secured party, an issue arises as to whether the claim can be asserted against the assignee. Section 9.318 deals, at least in part, with these situations.¹¹³

In *In re Alliance Health of Fort Worth, Inc.*,¹¹⁴ the court held that until actual notice of an assignment is received by the account debtor, the account debtor is entitled to set off any amounts owed to it by the assignor.¹¹⁵ The court noted that filing a UCC financing statement is not notice for purposes of section 9.318 and that the burden is on the assignor to show that the account debtor received notice.¹¹⁶ Because this showing had not been made, setoff by the account debtor was allowed and was not

111. See *id.* at 538. The court noted that the Texas courts had interpreted TEX. BUS. & COM. CODE ANN. § 9.204(c) (Vernon 1991) to require that future advances be in the reasonable contemplation of the parties when the agreement is made, citing *Western Auto Supply Co. v. Brazosport Bank of Texas*, 840 S.W.2d 157 (Tex. App.—Houston [1st Dist.] 1992, no writ). The Official Comment to revised TEX. BUS. & COM. CODE ANN. § 9.204 (Vernon Supp. 2000) notes that the revision liberalizes the rule as to future advances and "rejects the holdings of cases decided under former Article 9 that applied other tests, such as whether a future advance or other subsequently incurred obligation was of the same or a similar type or class as earlier advances and obligation secured by the collateral." See § 9.204 cmt. 5.

112. See TEX. BUS. & COM. CODE ANN. §§ 9.105(a)(1) & 9.318 (Vernon 1991).

113. TEX. BUS. & COM. CODE ANN. § 9.318 (Vernon 1991). The rules governing the relationships between assignors, assignees, and account debtors have been expanded considerably in revised Chapter 9. See TEX. BUS. & COM. CODE ANN. §§ 9.404-.406 (Vernon Supp. 2000).

114. 240 B.R. 699 (Bankr. N.D. Tex. 1999).

115. See *id.* at 704.

116. See *id.*

affected by the account debtor's bankruptcy.¹¹⁷

C. PRIORITIES

The average person who kicks the tires on a used car lot on a Saturday afternoon is more likely to be looking for body damage and mechanical problems than thinking about certificates of title. A floor plan financier, however, is more likely to be thinking about whether the car dealer will turn over the proceeds resulting from any cars that are sold. For almost any product other than cars, the financier probably has the bigger worry because section 9.307 protects a buyer in the ordinary course of business from the claims of an unpaid secured party.¹¹⁸ Under this rule, the financier of inventory usually has to rely on the policing of collateral to be sure that the seller is properly accounting for sale proceeds. In the case of used cars, however, the financier has some extra protection in the form of section 501.071(a) of the Texas Transportation Code.¹¹⁹

In *Bank One Texas, N.A. v. Arcadia Fin. Ltd.*,¹²⁰ a bank financed the inventory of a used car dealer. As part of the arrangement, the bank filed a financing statement as required by UCC section 9.302 to perfect its security interest.¹²¹ In addition, the bank followed the standard practice of taking physical possession of the certificates of title on the used cars pending sale and remission of the proceeds to the bank.¹²² The car dealer sold nine cars to various buyers and all these buyers financed their purchases through a finance company. The buyers were given physical possession of the cars, but none received a certificate of title at the time of sale. If matters had gone as planned, the dealer would have paid the sale proceeds to the bank and the bank would have released the titles to the buyers. However (and this will no doubt be a shock to the sensibilities of lawyers everywhere since, after all, if you can't trust a car dealer . . .), the dealer did not remit the proceeds to the bank.

Faced with this lapse of etiquette, the bank refused to turn over the certificates of title to the finance company and, instead, sued for a declaratory judgment that the bank had a prior perfected security interest in the cars. The finance company counter-claimed for conversion and tortious

117. *See id.*

118. TEX. BUS. & COM. CODE ANN. § 9.307 (Vernon 1991) provides, in part, that "a buyer in [the] ordinary course of business . . . takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence." This rule has been carried forward in revised TEX. BUS. & COM. CODE ANN. § 9.320 (Vernon Supp. 2000).

119. TEX. TRANS. CODE ANN. § 501.071(a) (Vernon 1999) provides, "A motor vehicle may not be the subject of a subsequent sale unless the owner designated in the certificate of title transfers the certificate of title at the time of sale."

120. 219 F.3d 494 (5th Cir. 2000).

121. TEX. BUS. & COM. CODE ANN. § 9.302 (Vernon 1991). The substance of this section has been carried forward, with several changes, into revised Chapter 9 in TEX. BUS. & COM. CODE ANN. §§ 9.309 -311 (Vernon Supp. 2000).

122. Although physical possession of a certificate of title does not perfect a security interest in the vehicle, it does prevent the possible sale of the vehicle accompanied by a transfer of the certificate of title by a dealer.

interference with its contracts with the nine buyers. The court held that as between the bank and the finance company, the sales were void because the buyers did not qualify as buyers in the ordinary course of business since they did not receive certificates of title at the time of sale.¹²³ The buyers, therefore, did not take free of the bank's security interest and the claims of the finance company failed.¹²⁴

In *Conoco, Inc. v. Amarillo Nat'l Bank*,¹²⁵ the court of appeals held, following remand from the Texas Supreme Court,¹²⁶ that the claim of a secured party for the conversion of proceeds by another creditor was barred by the two year limitations period applicable to conversion actions. The court ruled that through the exercise of reasonable diligence, the secured party could have ascertained the status of its security interest in the proceeds more than two years before the action was brought. Therefore, the discovery rule was not applicable to toll the running of the limitations period.¹²⁷

In another proceeds case,¹²⁸ the debtors sold a number of cattle in which a bank had a perfected security interest without accounting to the bank for the proceeds. In the debtors' bankruptcy proceeding, the bank successfully opposed the debtors' discharge to the extent of the proceeds for which the debtors were unable to account.

D. SECURED PARTIES AND BANKRUPTCY

In *In re Tri-Union Development Corp.*,¹²⁹ a corporation held properties that were subject to over 1000 oil and gas leases. After the corporation filed a Chapter 11 bankruptcy petition, it was discovered that 950 previously issued royalty checks had not yet been paid. In addition, as of the date of filing the petition, the debtor had not yet processed payments for a substantial amount of oil and gas production. The corporation sought permission to pay the 950 outstanding checks and to complete the processing of the other payments.

The court held that the royalty owners had perfected security interests in productions and proceeds under section 9.319 of the Code.¹³⁰ The corporation, therefore, could pay the outstanding checks and process the remaining payments prior to confirmation of a reorganization plan in the

123. See *Arcadia*, 219 F.3d at 497.

124. See *id.*

125. 14 S.W.3d 325 (Tex. App.—Amarillo 2000, no pet.).

126. *Conoco, Inc. v. Amarillo Nat'l Bank*, 996 S.W.2d 853 (Tex. 1999).

127. See *Conoco v. Amarillo Nat'l Bank*, 14 S.W.3d at 328-29. In reaching this conclusion, the court applied the two-part test established by *HECI Exploration Co. v. Neel*, 982 S.W.2d 881, 886 (Tex. 1998). This test requires (1) that the injury must be inherently undiscoverable, and (2) that the injury must be objectively verifiable.

128. See *In re Grisham*, 245 B.R. 65 (Bankr. N.D. Tex. 2000).

129. 253 B.R. 808 (Bankr. S.D. Tex. 2000).

130. See *id.* at 812. TEX. BUS. & COM. CODE ANN. § 9.319 (Vernon 1991) is a non-uniform Texas amendment to the Code creating an automatically perfected security interest in favor of mineral interest royalty owners. The section has been carried over in virtually its original form as a non-uniform amendment to the revised Chapter 9. See TEX. BUS. & COM. CODE ANN. § 9.343 (Vernon Supp. 2000).

Chapter 11 proceeding. The court ruled that all of the proceeds of the oil and gas production were cash collateral, and the cash could not be used for any other purpose without a court order and without protection for the royalty owners.¹³¹

In *In re Self*,¹³² a debtor executed a promissory note in favor of a bank to renew some earlier loans used to purchase a pickup truck and other equipment used in the debtor's business. The debtor filed a voluntary petition for relief under Chapter 13 of the Bankruptcy Code.¹³³ The bank filed a motion for relief from automatic stay.¹³⁴ The debtor asserted that the bank's interests were adequately protected because the vehicle was insured, and it proposed to pay the bank's secured claim in full at the contract rate of interest.

The court held that the creditor's interest in the collateral was adequately protected and that no relief from the automatic stay was necessary.¹³⁵ The court began its analysis by considering § 362(d)(2), which provides that a creditor has the burden of proving: (1) the amount of its claim; (2) that the claim was secured by a valid and perfected lien in the property; and (3) that the debtor lacked equity in the property.¹³⁶ The court then determined that the burden shifted to the debtor to prove that the property was necessary for an effective reorganization.¹³⁷ The court held that the debtor met this burden by proving that the collateral was necessary in the day-to-day operations of his business, which precluded the court from granting relief under section 362(d)(2).¹³⁸

The bank also requested relief under section 362(d)(1). The court held that the creditor had to prove that it had a valid and perfected lien on the property, and that a decline in the value of the collateral was occurring or

131. See *Tri-Union*, 245 B.R. at 814. In its analysis, the court reasoned that under TEX. BUS. & COM. CODE ANN. § 9.319(q)(3) (Vernon 1991), a Texas royalty interest owner has a security interest and can qualify as a first purchaser as defined in that section. According to the court, this section applies whether the royalty is in kind or paid in cash. The term "interest owner" is defined expansively under TEX. BUS. & COM. CODE ANN. § 9.319(q)(2) (Vernon 1991) and includes all royalty and working interest owners. To have a security interest under TEX. BUS. & COM. CODE ANN. § 9.319 (Vernon 1991) there must be written evidence that the interest holder has a right under real estate law and the first purchaser must voluntarily communicate to the interest owner an acknowledgment of his or her rights. A first purchaser is one who acts "as an operator who received, on behalf of royalty owners, production proceeds from third party purchasers." Prior to 1987, it is likely that section 9.319 would only have applied to royalty interests that were collected in kind. However, amendments in 1987 evidenced the legislature's intent to also protect those royalty owners who received monetary payments. In some instances a bona fide purchaser can cut off the claims of the interest holder. However, when the proceeds are either cash or accounts the interests are perfected upon filing and are not cut off by a bona fide purchaser.

132. 239 B.R. 877 (Bankr. E.D. Tex. 1999).

133. See 11 U.S.C.A. §§ 1301-1330 (West 1997).

134. See *Self*, 239 B.R. at 878. The automatic stay comes into effect upon the filing of a bankruptcy petition under 11 U.S.C.A. § 362(a) (West 1997). A motion to lift the stay is permitted by 11 U.S.C.A. § 362(d)(1) (West 1997).

135. See *Self*, 239 B.R. at 882.

136. See *id.* at 880.

137. See *id.*

138. See *id.* at 881 (citing 11 U.S.C. § 362(d)(2)).

was threatened because of the automatic stay.¹³⁹ If the creditor proved this, the burden then shifted to the debtor to prove that the collateral was not declining in value or that the creditor was adequately protected.¹⁴⁰ While the creditor did establish a prima facie case under section 362(d)(1), the court noted that the determination of whether a creditor's interest is adequately protected is not an exact science. Instead, the court stated that it was required to balance all of the relevant factors in the case, including the value of the collateral, whether the collateral was likely to depreciate over time, the debtor's prospects for a successful reorganization and the debtor's performance under the plan.¹⁴¹ The debtor claimed that the bank's interest in the collateral was adequately protected because he maintained proper insurance on the vehicle and was current on his plan to repay the loan. Conversely, the bank claimed that the only way it could be protected was by the entry of an order directing the debtor to make interim payments to the bank in the pre-confirmation period. The court determined that the imposition of direct protection payments was not a proper remedy in a Chapter 13 context.¹⁴² Furthermore, there was no evidence that the debtor would not be able to fulfill his financial obligations to the creditor in the future. Therefore, the court determined that the bank's interest in the collateral was adequately protected and that no protective relief was warranted.¹⁴³

E. ENFORCEMENT OF SECURITY INTERESTS AFTER DEFAULT

In *Al Gailani v. Riyadh Bank Houston Agency*,¹⁴⁴ the makers defaulted on a note and the secured party foreclosed on the accounts receivable. Following notice to the debtor and to the general public, the accounts were sold at a public sale where the secured party purchased the accounts for ten dollars and sued for a deficiency of \$1,908,309.51. The secured party moved for summary judgment against two of the co-makers and this motion was granted by the trial court.

On appeal, the co-makers argued that the secured party had attempted to collect from the account debtors by placing their names on a "black list" maintained by the Saudi Arabian Monetary Agency, thereby preventing the account debtors from obtaining banking services in Saudi Arabia. The co-makers further contended that the effect of this action was to destroy any confidence a potential bidder might have in the account debtor's or co-makers' ability to repay the underlying loan.¹⁴⁵

The court held that the co-makers' first argument raised a fact issue as to whether placing the account debtors' names on a "black list" was an attempt to collect from the account debtors that would invoke the re-

139. *See Self*, 239 B.R. at 881.

140. *See id.*

141. *See id.*

142. *See id.*

143. *See id.* at 882.

144. 22 S.W.3d 560 (Tex. App.—El Paso 2000, pet. filed).

145. *See id.* at 565.

quirements of commercial reasonableness under section 9.502.¹⁴⁶ The court further held that the co-makers' second contention that the effect of placing the names on a black list decreased the value of the accounts raised a fact issue as to whether the secured party acted in a commercially reasonable manner under section 9-502.¹⁴⁷

Summary judgment in favor of the secured party was reversed and the case was remanded for trial.¹⁴⁸

In *Fair Deal Auto Sales v. Brantley*,¹⁴⁹ a debtor purchased a car from a dealer and made a down payment of \$1700. The financing agreement stated that the down payment due was \$2100. The financing agreement also listed two additional down payments of \$250 each to be paid prior to the first installment payment, which was due a week after the car was purchased. The dealer told the debtor, contrary to the written agreement, that this \$500 was for payment of tax, title, and license fees and could be paid with the first monthly car payment rather than within a week. The debtor, therefore, believed that no payments were due before the first monthly payment. About two weeks after the debtor purchased the car, the dealer repossessed the vehicle, claiming that the debtor was late on the first additional down payment of \$250. The debtor sued the dealer for wrongful repossession.

The court, quoting the trial judge's description of the transaction as a "rip-off," held that the dealer wrongfully repossessed the car by misrepresenting the terms of the financing agreement.¹⁵⁰ The court stated that a financing agreement must be consistent with what the creditor tells the debtor and it must be signed, dated, and in writing.¹⁵¹ In this case, since the signatures on the financing agreement were not dated and because of the inconsistency between the terms orally conveyed to the debtor and those listed in the agreement, the dealer could not rely on the agreement as justification for its actions.¹⁵² The court upheld an award of damages against the dealer.¹⁵³

146. See *id.* at 564-65 (citing TEX. BUS. & COM. CODE ANN. § 9.502 (Vernon 1991)).

147. See *id.* at 565.

148. See *id.* at 566.

149. 24 S.W.3d 543 (Tex. App. Houston [1st Dist.] 2000, no pet.).

150. See *id.* at 547.

151. See *id.*

152. See *id.*

153. See *id.*

